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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-1059

KERN COUNTY LAND COMPANY,
Petitioner,

v.

OCCIDENTAL PETROLEUM CORPORATION,
Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION

Occidental Petroleum Corporation ("Occidental") submits this memorandum in opposition to the petition filed by "New Kern" for review of a decision by the Court of Appeals for the Second Circuit in regard to certain events involving the parties, petitioner's predecessor ("Kern") and its present corporate parent ("Tenneco") under § 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78p(b)) (the "Act").*

Questions Presented

1. Whether, on the facts of this case, the grant of a long-term option, which could not and did not result in a sale within six months, was a short-term "sale" of securities subject to the option under § 16(b).

* References herein by page number are in the form set forth in the petition.

2. Whether, on the facts of this case, the forced transformation of stock by a "defensive merger" engineered by petitioner's predecessor and its parent must be imputed to respondent as its "sale" under § 16(b), when such transformation involved no opportunity for abuse of "inside" information.

Proceedings Below

This case is one of four actions, including three shareholder actions, which were consolidated for discovery, 44 F.R.D. 543 (S.D.N.Y. 1968), in which all parties participated. Each plaintiff moved for summary judgment. The district court granted petitioner's motion and dismissed the three shareholder actions as moot (24C); no appeal was taken by those parties.

On respondent's appeal the Court of Appeals for the Second Circuit, in an opinion by Chief Judge Friendly, unanimously reversed and directed dismissal of the complaint in accordance with respondent's explicit request on brief and at argument. The panel, which included a former general counsel of the Securities and Exchange Commission, also unanimously denied petitioner's application for rehearing. The full active membership of the Second Circuit denied petitioner's application for rehearing and for rehearing in banc by a vote of eight to one.

Petitioner's current contention that factual development of this case was "limited", and thus that the court below dismissed it prematurely, came only after the uncontested facts yielded a result unsatisfactory to it. In the opening of its appellate brief petitioner told the court:

> [E]ntry of summary judgment came after this litigation had been pending some three years and after extensive discovery had been had, . . .[a]

[a] Brief for Appellees at 2-3, *Abrams* v. *Occidental Petroleum Corp.*, 450 F.2d 157 (CA 2 1971) (Aug. 16, 1971).

and at two points carefully listed the pretrial discovery taken,[b] pressing the position that the case was ripe for decision, until the Court of Appeals ruled. (17A)

Reasons for Denying the Writ

Contrary to petitioner's contention, this case does not present any broad issue of law. The decision required only the application of principles announced in *Blau* v. *Lehman*, 368 U.S. 403 (1962), again recently endorsed in *Reliance Electric Co.* v. *Emerson Electric Co.*, No. 70-79, 404 U.S.— (Jan. 11, 1972), and followed in the Second Circuit and elsewhere, to the particular facts here. That application was entirely correct.

The court below, following a well established test, held that the forced transformation of a defeated bidder's shares into those of another corporation in a merger wholly within the control of others is not a "sale" by such bidder, and no § 16(b) liability follows, provided that the transactions do not permit the abuse of inside information. The test, which petitioner concedes to be the correct one, requires a careful examination of the facts and the sequence and timing of events. It has been and must hereafter be applied on a case-by-case basis. A decision on the facts of this case cannot resolve future merger cases, "defensive" or otherwise. In addition, as set forth *infra*, more sophisticated "defensive" techniques, creating no § 16(b) questions, would appear to have overshadowed the "defensive" merger. The rare occasion where a hostile management will procure and rush through a merger within six months, as was done here, does not merit plenary consideration. Even in such unusual situations, the result urged by petitioner would allow such managements to destroy the "delicate balance"

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b *Id. at* 3, 20.

in tender offer contests which Congress, in passing legislation[c] after the events herein, took care to preserve.

Similarly, the Court of Appeals' holding that the mere grant of an option, economically bona fide, is not a § 16(b) "sale" accords with an unbroken line of prior decisions. The grantor of an option has no power to effect any sale, but rather leaves his investment at risk in the issuer's securities. A sale occurs only when and if the optionee exercises, and here no sale was made within the statutory period. There is no conflict here with the Seventh Circuit's decision in *Bershad* v. *McDonough*, 428 F.2d 693 (CA 7 1970), *cert. denied*, 400 U. S. 992 (1971), meticulously analyzed in Judge Friendly's opinion, where the "option" was a sham. Both courts, on summary judgment, applied the same principles to different facts with different results.

The contention that this part of the decision opens an "escape hatch" from § 16(b) is based upon inaccurate statements as to the mechanics of and risks inhering in the grant of a long-term option, which can assure no profit of any kind but rather encumbers its grantor. It is, as shown herein, an "escape hatch" only from nonexistent liability. The Second Circuit has given fair warning that spurious "options" will allow an insider no escape.

Petitioner's primary ground for review is apparently that a profit (long-term) was made. The question is not whether a profit was made but whether § 16(b) applies. *Reliance Electric Co.* v. *Emerson Electric Co., supra.* The Court of Appeals, applying accepted principles, reached the only proper result on the facts by denying windfall recovery to the petitioner, where neither the purpose nor the mechanics of § 16(b) had any application, and the court below was not therefore pressed to a result which would have been "repugnant" to its "sense of equity" (13A). There is no need for review.

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[c] The Williams Act Amendments to the Act, see p. 26 *infra*.

Counterstatement of Facts

Petitioner's statement omits so many facts relevant to the propriety of review that it is necessary to submit this counterstatement.

A. *Occidental's attempt to arrange a merger with Kern.*

In late March of 1967 Occidental discussed a possible Kern merger with Lehman Brothers, Occidental's investment banker, which viewed it as beneficial for both companies (722a). After unsuccessful attempts in April 1967 to schedule a meeting with Kern (550a; 762a), Occidental on May 8 released the terms of a public tender offer to Dow Jones for publication over the "broad tape", followed the next day by newspaper publication (763a).

Occidental offered to purchase up to 500,000 shares of Kern stock for $83.50 per share plus $1.50 commission to transmitting brokers. The offer was unconditional and irrevocable until June 8, 1967, requiring Occidental to accept all tenders, however few (450a, Ex. a; 759a-760a). Occidental reserved the right to purchase, in order of receipt, some or all shares tendered beyond 500,000 and the right to extend the offer on public notice (*id.*). The offering price of $83.50 was approximately $20—or 30%—above the prior closing market price (63⅝) of Kern Stock (763a) and was set with Lehman Brothers' guidance, based upon published data (723a-724a). Within 2½ days after announcement tenders exceeded 500,000 shares, and on the third day an irrevocable extension for an additional 500,000 Kern shares was made (767a; 1061a).

On the day of the offer Kern's board of directors met specially and determined to "use every legitimate means to

frustrate Hammer's[d] ambition to take over your Company [Kern]" (782a). Kern wrote to its shareholders on May 10, urging them not to tender, stating, *inter alia*, that it had "in hand . . . a number of offers to discuss merger possibilities . . . that could result in tax-free exchanges" (782a-785a), which statement was then untrue. Kern had no other offers (805a; 901a; 772a; 724a; 655a; 645a). Upon the extension of the offer it telegraphed, and thereafter again wrote to each shareholder, urging defeat of the offer. (785a; 768a).

Despite Kern's active resistance (1062a; 769a) Occidental sought to discuss a consensual merger. Occidental submitted two merger proposals, each on a "negotiable" basis, but Kern refused to discuss them (644a-645a; 658a; 769a). Late on May 19 Kern announced that its board had voted to accept a Tenneco merger offer[e] and told Occidental to "read about in in the newspapers." (770a).

The news release (787a-788a) revealed that the Tenneco offer, accepted "unanimously," was a tax-free, share-for-share exchange of Kern stock for a proposed $5.50 Tenneco convertible preference stock with a liquidation value of $100, a cumulative dividend of $5.50 per share and callable in ten years at $110. Lehman Brothers advised that the Tenneco proposal was worth $105 per share (745a), or 23% above Occidental's own offer; Occidental made public this valuation by announcement to its shareholders dated May 19 (710a, Ex. D at D7-D8).

Tenneco was first contacted by Kern on May 10 or 11 when Kern's Chairman (Montgomery) asked Tenneco's late Chairman (Symonds) to come up with an offer to

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d President of Occidental.

e Although the Tenneco-Kern transaction was styled as an exchange of stock for assets, see note o and p. 11 *infra*, the term "merger" is used here for shorthand purposes.

counter Occidental (726a-727a; 772a; 805a). Tenneco insisted upon studying Kern's records (725a) and on May 11 commenced a detailed examination, working from an office within Kern. No earlier than May 16, 1967 Tenneco and Kern met "for a general discussion of the framework within which Tenneco might make an offer," subject to further inspection (727a-728a). Tenneco had access to inside information, and its offer was based thereon (726a-728a). Occidental was isolated throughout (728a; 772a-773a).

B. *Aftermath of Tenneco's Offer; the Option Agreement.*

The May 19 announcement of the Kern-Tenneco agreement put an end to Occidental's bid, which after May 19 drew only a few shares on scattered dates through June 5 (771a). It was clear to Occidental that, even if it waged a costly and bitter proxy fight, it was not likely to stop the proposed Tenneco-Kern merger (729a).[f] Occidental and Tenneco met in late May and attempted to cope with the prospect, viewed unfavorably by both (729a, 730a), that Occidental, having sought to acquire Kern, would ultimately become a minority shareholder of Tenneco. They considered the possible sale of Occidental's Kern shares to Tenneco, but believed this could not be done in view of the "possibility of a 16B problem" (730a).

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f With a $75 million investment at stake, Occidental thereafter made a demand upon Kern to examine its corporate records, was repeatedly refused, and was forced to institute two state court actions in an attempt to secure an unqualified right equally available to any shareholder under Cal. Corp. Code § 3003 (West 1955) (669a-670a; 678a-681a; 849a-867a). Only after these proceedings were instituted did Kern produce any records, which did not go beyond that available to any shareholder (4A), and none related to the value of the Tenneco offer (773a). What was made available to Occidental is irrelevant; the question is whether the merger exchange allowed Occidental to use it unfairly. See Point II *infra*.

At the suggestion of the late Mr. Symonds, Occidental,[g] along with its counsel, Pillsbury Madison & Sutro, met with Tenneco[h] and its counsel, Cahill Gordon Sonnett Reindel & Ohl, on June 1, 1967 at the latter's New York office (731-734a; 584a-585a). The parties entered into an agreement whereby Occidental, both to comply with § 16(b) and to qualify for capital gains treatment under the Internal Revenue Code, if the shares were later sold (737a; 732a), agreed not to dispose of its investment for at least more than 6 months, and for up to 14 months, beyond June 8, 1967[i] (464a). For a period beginning after December 9, 1967 and up to July 31, 1968, depending upon when Tenneco and Kern chose to close the merger, if they did, Tenneco Corporation (Tenneco's subsidiary) would have a transferable right to purchase not Occidental's Kern shares but the then nonexistent preference shares which might come to Occidental if the merger were effected (462a-463a). Occidental had no right to compel Tenneco or any transferee to purchase such shares at any time. Tenneco would pay for this "call" option, but if no merger occurred by July 31, 1968 (14 months later) Occidental would return the option "premium" paid (461a-465a).

From the meeting a call was made to Donaldson Lufkin & Jenrette, Inc., a New York investment house with expertise in the option market, to determine the current price of a "call" on shares selling in the range of the Kern shares, then trading in the mid-90's. It advised that the premium for a six-month call varied from $9 to $12 per share, depending upon the inclusion of conditions outside a standard call

g By Walter R. Davis, then Executive Vice President of Occidental (555a).

h By the late Mr. Symonds. (*Id.*)

i Because the tender offer was irrevocable until June 8, Occidental might theoretically receive more tenders until that date.

contract (747a-748a; 556a-557a; 776a). Despite the extended holding period and refund provisions the premium was placed low in the range suggested at $10. The stated option price was $105, but the premium was to be creditable against the stated price, making the effective exercise price $95 per share (790a; 462a), which was not below current market.

Both parties were unfamiliar with the technicalities of § 16(b) and relied upon their attorneys (731a-734a), who agreed upon the option (743a-744a). The negotiators were advised,[j] as later was Kern, that the grant of an option to Tenneco was not within § 16(b) (733a-734a; 737a-738a; 744a). The agreement was executed on June 2, 1967.

Tenneco also promised to postpone the listing and registration of the proposed Tenneco preference shares under § 12 of the Act until the option either was exercised or expired.[k] In mid-June steps were taken to do so, and based thereon Occidental moved to dismiss its actions for inspection of Kern's records (510a-512a).

The option agreement was not conditioned explicitly or implicitly upon Occidental's either supporting or not opposing the proposed merger (750a-751a) and was executed well after public release of the May 19 merger announcement. The Kern proxy statement of June 16, preliminary to the special shareholders' meeting, set forth the substance of the option agreement and stated that Tenneco Corporation "has not determined whether it will exercise its option, . . . Depending on future investment market conditions, Tenneco Corporation may sell the option or

j Based on this advice Kern and Tenneco set forth the terms of the option in the proxy statement of June 16, 1967, but made no suggestion that it might give rise to a § 16(b) claim (736a-738a).

k This was to remove the proposed Tenneco shares from § 16(b) and to avoid a claim that a double holding period was required and is explained in the Court of Appeals' decision (5A-6A n.6).

the Preference Stock covered by the option; its present intention is not to purchase such Preference Stock as an investment." (980a, Ex. I at 3).

Petitioner fails to indicate that Tenneco Corporation never exercised its option. On August 16, before the merger was effected, the option was sold by Tenneco Corporation to Loeb, Rhoades & Co. for at least the price it had paid Occidental (557a; 414a),[l] and the option was subsequently transferred to the LR Fixed Invetment Trust (247a; 265a; 414a).

C. *Efforts to Obtain a Rule "16b-11" from the SEC*

To deal with the problem that the Kern-Tenneco merger might itself be alleged to be a § 16(b) "sale", Occidental proposed to apply to the SEC for a rule of general application which would exempt a merger within six months of acquisition by public tender offer from § 16(b), (512a-513a; 433a; 1067a), and Tenneco agreed to aid in the application (570a-572a).[m] Occidental also believed it had received Tenneco's assurance to delay the closing if the administrative application were unsuccessful (777a-779a; 735a-737a; 269a; 520a-522a); although Tenneco had assured full cooperation to avoid acts which might trigger

l The call was sold to qualify the merger for tax-free treatment under an IRS ruling (557a).

m The Pillsbury firm sent copies of the proposed rule and other related material to petitioner's counsel (433a). One letter recounted the reaction of Phillip Loomis, Jr. of the SEC: "He was sympathetic. He was most impressed by the fact that the only alternative that Occidental had was to commence every kind of litigation it could reasonably bring and attempt to forestall the consummation of the Tenneco-Kern transaction for six months." (571a) On the basis of this communication petitioner apparently claims that Occidental had decided to initiate litigation in the event of a failure of efforts at the SEC (Petition at 8 n). Petitioner's reference to litigation undertaken to stop the merger omits to state that the closing of the merger took place in violation of an injunction issued by a court of the State of Texas (817a), also contrary to the Plan of Merger (456a at A-18, A-21).

§ 16(b) liability (734a; 740a), this aspect of the agreement was disputed and played no role in the decision below (17A).

On July 12 the SEC declined "at the present time" to publish a rule for comment. A revised rule was submitted, but the SEC again declined to take any action with regard to the application (1067a), expressing no view as to the merits of this particular case.[n]

D. *The Plan of Merger (the "Plan")*

The Plan (456a, *et seq.*) was based upon the offer approved on May 19 by Kern's board and provided for the transfer of Kern's assets and business to "New Kern" and a share-for-share exchange of Kern stock for the new Tenneco preference stock. Each new Tenneco share would pay a fixed quarterly dividend of $1.375 accruing from issuance (980a, at 2, B-1 to B-5) and after July 1, 1969 became convertible into 3.6 shares of Tenneco common stock (*id.*). Kern agreed to have this new stock distributed promptly to its shareholders upon closing in exchange for their shares. The Tenneco stock would be issued without being registered under § 12 of the Act and until registered was not tradable on a national securities exchange (794a; 476a).

The Plan was contingent upon shareholder approval at a special meeting called for July 17 (980a), a favorable tax ruling from the IRS, issuance of necessary permits, licenses and authorizations from appropriate California authorities and numerous material conditions. It provided for a closing between September 30 and December 31, 1967 or at "such other time" as the parties might agree upon (456a at A-16), and contained omnibus clauses under which the parties could change the terms of the agreement and waive compliance with its covenants and obligations (456a at A-23).

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n Petitioner appears to contend for the first time that by proposing a rule to the SEC, Occidental must be deemed to concede that a merger is a "sale" (Petition at 7 n.). All such implications were firmly rejected by the court below: "It is not contended that we should draw any inference from this, and we do not do so." (6a n. 7)

E. *Shareholder Approval*

Kern's management had no concern about shareholder approval of the Plan or any opposition by Occidental (752a). It was constructed so that approval by a simple majority of shares was required with no right to elect appraisal,[o] and the shareholders were voting on a 68% increase in the value of their pre-tender offer holdings. At the special meeting Occidental abstained (877a; 980a at 2).[p] The Plan was adopted by over 99% of all shares voted (651a). A representative of Occidental appeared at the meeting and read a letter explaining why Occidental had decided not to vote for the merger (458a-459a, as corrected, 460a).

F. *Acceleration of the Merger Closing*

Kern and Tenneco moved to accelerate the closing in advance of the dates set forth in the Plan and Proxy Statement. Occidental met with Tenneco to remind it of its prior assurances and requested it to defer the closing but was refused (739a-744a). Tenneco applied to the California Commissioner of Corporations on August 8 for the requisite authorizations, which were granted over Occidental's objections on August 30 (1070a). Kern and Tenneco elected to close on the same day (484a-486a). Concurrently, Kern expressly assigned to New Kern all claims it had under the Act (466a), which included the claims proposed to be made against Occidental under § 16(b) (414a; 570a).

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o Casting the transaction as an exchange of assets avoided the requirement of a ⅔ vote and the right of appraisal which would be applicable to a merger. Cal. Corp. Code §§ 3901, 4107, 4123 (West 1955).

p This had the effect of a "no" vote. *See* Cal. Corp. Code § 3901 (West 1955).

G. *Disposition of the Tenneco Stock*

Occidental did not surrender its Kern shares until December 11, 1967 (247a; 265a; 414a) when, more than six months after Occidental's most recent acquisition of Kern shares, and even longer after the execution of the option, LR Fixed Investment Trust exercised the option. Occidental exchanged its Kern shares for the new Tenneco preference stock; delivered 886,623 optioned shares to the Trust; and was paid $95 per Tenneco share by the Trust as provided in the option, amounting to $84,299,185 (*id.*).

POINT I

Whether the long-term option in this case was a genuine option and therefore not a "sale" under § 16(b) is not a question which merits review.

A. *The case was correctly decided in accordance with accepted law.*

The court below merely adhered to the principle, followed by all courts in applying § 16(b), that no "sale" occurs unless and until the "insider" acquires at least a *right* to sell securities at a price certain. In submitting to a call option, Occidental obtained no right to compel any sale, at any time, or at any price, and thus made no "sale" under § 16(b), and the statute has always been so interpreted.[1]

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1 *Silverman* v. *Landa*, 306 F.2d 422 (CA 2 1962), *affirming* 200 F. Supp. 193 (S.D.N.Y. 1961), held that "a call-option is not a sale of the underlying security;" 306 F.2d at 425, "the insider-*optionor's* position in the underlying security is not fixed when he sells the *option*, but when the option is exercised," *id.* at 424 n.4, since "any change [in ownership] would occur at the pleasure of the optionee." *Id.* at 424; *accord*, *Blau* v. *Ogsbury*, 210 F.2d 426, 427 (CA 2 1954). Precisely the same analysis had been set forth in *Stella* v. *Graham-Paige Motors Corp.*, 232 F.2d 299, 301 (CA 2), *cert. denied*, 352 U. S. 831 (1956); *Falco* v. *Donner Foundation, Inc.*, 208 F.2d 600 (CA 2 1953); *Shaw* v. *Dreyfus*, 172 F.2d 140 (CA 2), *cert. denied*, 337 U. S. 907 (1949); *Park & Tilford* v. *Schulte*, 160 F.2d 984 (CA 2), *cert. denied*, 332 U. S. 761 (1947); and it accords with the opinions issued by the General Counsel for the SEC, 11 Fed. Reg. 10968 (1946); *see* Cook & Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 385, 401-02 (1953).

Judge Friendly's opinion carefully distinguished between the instant situation and one where an insider buys a "put" and thus acquires a right to sell the securities at a fixed price (16A). Even that different situation would pose its own range of problems under § 16(b).

Section 16(b) may not be expanded beyond its express limits to "impose its extraordinary liability" on transactions other than purchases and sales of equity securities, thereby changing "an interpretation of the Act unbroken since its passage." *Blau* v. *Lehman, supra,* 368 U.S. at 409, 413; *Reliance Electric Co.* v. *Emerson Electric Co., supra* (slip opinion at 9). The court below correctly declined to expand § 16(b) to include an event which did not constitute, and would not permit, a sale of equity securities within the statutorily defined six-month period.

The same rule was applied here as in *Bershad* v. *McDonough, supra,* upon which petitioner relies. In *Bershad* the court held that "The commercial substance of the transaction rather than its form must be considered." 428 F.2d at 697. The court below undertook to "look through the form of an option to the economic realities" to determine objectively whether "in truth and fact a sale had occurred when the 'option' was granted" (13A-14A). It concluded from undisputed facts that the agreement here was no more than an option and that there was "no basis" for holding otherwise (13A-14A). The two cases turned on different facts, undisputed in each instance.

There was no "alternative holding" in *Bershad* that the grant of an option is a "sale" as a matter of law. Generalized comment there on *other* possible abuses of options created no "holding" in a case where the *only* issue was whether the purportedly optioned stock had in fact been sold. The court expressly removed itself from any controversy about an expansion or narrowing of the statute,

stressing its intention solely to examine the substance of the agreement, 428 F.2d at 697 n.5, just as the court below did. Indeed, had the *Bershad* court held that the grant of an option was a "sale" on a theory that the premium "extracted" profits from the subject stock, as petitioner claims (Petition at 13), this would have been in direct conflict with *Silverman* v. *Landa, supra.*[2] But it had no cause to mention that case because it did not so hold and did not have an option before it.

B. *There is no "factual identity" here with Bershad v. McDonough.*

In *Bershad* v. *McDonough, supra,* a controlling director (and his wife) executed a purported short-term "option" on their recently purchased control block of Cudahy stock. The insider transferred all of the incidents of ownership to the purported "optionee" through, *inter alia,* the grant to the "optionee" of an irrevocable proxy which conveyed full corporate power, the resignations of the insider and his associate from the board, and the placement of the

2 In *Silverman* v. *Landa, supra,* which like the case here involved a long-term option, it was alleged that the insider, by issuing one-year calls and a put, had realized a profit by receipt of the 16.4% premium on the calls sold and an 8.2% premium on the put sold. Plaintiff argued that by the grant of the options, the insider had immediately insulated 20.6% of his risk, roughly the equivalent of immediately buying high and selling low within the range of the "straddle"; and that, as an insider, he could foresee that the price of the stock would remain stable during the term of the options and would keep the entire premium as profit. Both the district and appellate courts rejected the argument and held that § 16(b) applies solely to purchases and sales of equity securities, and that because the option was long-term, the contention that the insider could be held to foresee the price of the stock beyond 6 months went impermissibly beyond the presumption available under § 16(b), 306 F.2d at 425; 200 F. Supp. at 116. The case was urged as a conflict by the petitioner in *Bershad,* and this Court denied review.

"optionee's" five nominees thereon. Plaintiff alleged that the transaction amounted to "more than" an option. *Bershad* v. *McDonough*, 300 F. Supp. 1051, 1054 (N.D. Ill. 1969). The district court so held on his motion for summary judgment, and the Seventh Circuit affirmed, stating:

> The circumstances of the transactions clearly indicate that the stock was effectively transferred, for all practical purposes, long before the exercise of the option. 428 F.2d at 698.

Or, as the court below put it, "the stock had in fact been sold" (15A).

Occidental transferred neither directorships nor control, for, as petitioner concedes, it was a disfavored minority shareholder and had neither. The option was not implicitly or explicitly conditioned upon Occidental's supporting or acquiescing in the merger. Even giving consideration to its impermissible proffers of matter not in the record,[3] peti-

3 Petitioner's assertion that Occidental later gave a proxy to its own counsel, coupled with the statement that the absence of such evidence in the record is attributable to incomplete discovery (Petition at 7n.), is disingenuous. There was obviously no need for discovery on a matter of which petitioner's counsel claims to have personal knowledge. The matter was, moreover, the subject of pretrial deposition at which counsel in all four cases attended and examined (Deposition of Occidental by Walter R. Davis at 41, 79). Since both the district and circuit court decisions in *Bershad* v. *McDonough, supra,* were rendered during proceedings in the district court and were cited in petitioner's briefs there, petitioner's attempt on a petition for review to introduce evidence after a deliberate bypass of an opportunity to make a record on these assertions (including its muteness during all the proceedings before the court below ruled) is clearly impermissible. *Lawn* v. *United States*, 355 U.S. 339, 354 (1958); *McClellan* v. *Carland*, 217 U.S. 268, 282-3 (1910); *Jones* v. *Zurich Gen. Acc. & Liab. Ins. Co.*, 121 F.2d 761, 764 (CA 2 1941); *Bassick Mfg. Co.* v. *Adams Grease Gun Co.*, 54 F.2d 285, 286 (CA 2 1931), *cert. dismissed*, 286 U.S. 567 (1932). Such material should properly be striken from the petition. But it is not necessary here to rely upon procedural impropriety. Assuming, *arguendo*, the substance of the assertions at face value, Occidental's giving a proxy to its own counsel, revocable

tioner's attempt to remold this case to fit *Bershad* fails. There the transactions passed effective ownership of the stock immediately to the alleged "optionee" and served only that function. Here petitioner stresses Occidental's failure to persist in pointless acts of opposition to the merger; the only effective step Occidental could have taken was to outbid Tenneco's richer offer. Its failure to do so, before or after the option, does not convert the option into a sale. Petitioner's view would require the prolongation of opposition only for charade. Even in attempting to avoid that waste Occidental, unlike the *Bershad* defendant, did not transfer any ownership rights to Tenneco.

In *Bershad* the court also found that the payment of 16.7% of the exercise price (14% of the option price) for a 10 week option was a "deterrent" to non-exercise. 428 F.2d at 698. This substantially exceeded the 10.5% of exercise price (9.5% of option price) premium here paid for an option that would run from 6 to 14 months at the will of the optionee. The $10 premium here was based upon the judgment of a qualified third person and permitted no inference that it was a penalty for non-exercise. Once paid, the $10 premium did not reduce the effective exercise price ($95) below current market and thus did not shift the

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as a matter of law under Cal. Corp. Code §§ 2226, 2228 (West 1955), only for the purpose of voting for a merger which it could not realistically prevent, together with whatever personal assurances Occidental's outside counsel is said to have given Tenneco's counsel, obviously gave no right of any kind to Tenneco, and does not compare to the facts in *Bershad*, where the controlling shareholder gave an irrevocable proxy to the "optionee", immediately effective and unlimited as to purpose, transferring effective ownership. Indeed, petitioner, by its repeated failure to raise the issue in either the district court or on appeal, implicitly so admits. Occidental did not vote its shares in favor of the merger, and its vote was not needed. The Second Circuit gave this new assertion the weight it deserved in denying the petition for rehearing, in which it was first raised, without even requesting a response, and had previously indicated that how Occidental might vote was inconsequential (12A n.13).

undertaking into a commitment to exercise. The premium bought time, not equity. The difference between this and the *Bershad* "option" followed *a fortiori* from the fact that the premium, ordinarily always retained by the optionee, would here be returned if there was no merger before July 31, 1968. Petitioner's claims below were flatly contradicted by both the objective economics of the option and its own declaration to shareholders, while the option was outstanding, that it was uncertain whether it would exercise it even if the merger occurred (980a).[4]

If the point need be pressed further, in *Bershad* the "option" itself was *short-term*, expiring in 10 weeks. Here, as in *Silverman* v. *Landa, supra*, the option was long-term, and in the instant case it could be exercised only long-term.

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4. While conceding that the effective exercise price of the option was not below market and that the premium was based on the Donaldson opinion, petitioner for the first time in its petition for rehearing asserted that the evidence on the reasonableness of the premium was hearsay. Petitioner did not dispute that the advice had been given, nor did it assert that it had any contrary evidence but apparently sought remand so that it might procure an "expert" who might second-guess the Donaldson opinion four years after the fact. Petitioner's failure to raise technical objections to this evidence in the district court vitiated any such objections, *Auto Drive-Away Co. of Hialeah, Inc.* v. *ICC*, 360 F.2d 446, 448-449 (CA 5 1966); *Klingman* v. *Nat'l Ind. Co.*, 317 F.2d 850, 854 (CA 7 1963); *Mitchell v. Dooley Bros. Inc.*, 286 F.2d 40 (CA 1 1960), *cert. denied*, 366 U.S. 911 (1961), *a fortiori* so in view of its continued silence in the appellate court (17A). And, of course, the premium accords with the standards set forth in public sources. See D. VAUGHN, SURVEY OF INVESTMENTS 41 (1967) ("the cost of a six month contract is approximately 12 percent of the market price of the stock"); W. J. EITEMAN, C. A. DICE & D. K. EITEMAN, THE STOCK MARKET 316-17 (4th ed. 1966) ("premiums paid by buyers of a six-month calls amount to about 14 percent of the value of the stock. The percentage premium on low-price stocks would probably run somewhat above this, and the percentage premium on high-priced stocks would probably run slightly below"); SEC, REPORT ON PUT AND CALL OPTIONS 84, 85 (1961) (Six-month calls were approximately 12 percent of the value of the stock; price of one-year calls approximately 164.8% of the price of six-month calls.) The call agreement in the present case was from more than 6, to 14 months.

The claimant might properly assert in *Bershad* that exercise was "inevitable", for the insider could be held to know that the stock prices in the short-term would ensure exercise. But § 16(b) does not permit a presumption that Occidental could foresee that, when the option first became exercisable *more than six months later*, the price of the stock would then favor or even permit exercise, or would otherwise render its grant profitable. *Silverman* v. *Landa, supra,* 306 F.2d at 425; *see Blau* v. *Max Factor & Co.,* 342 F.2d 304, 308 (CA 9), *cert. denied,* 382 U. S. 892 (1965); *Roberts* v. *Eaton,* 212 F.2d 82, 85 (CA 2), *cert. denied,* 348 U. S. 827 (1954); *Steinberg* v. *Sharpe,* 95 F. Supp. 32, 34 (S.D.N.Y.), *aff'd* 190 F.2d 82 (CA 2 1951); *cf. Booth* v. *Varian Associates,* 334 F.2d 1, 4 (CA 1 1964), *cert. denied,* 379 U. S. 961 (1965). Moreover, the option here was on shares of Tenneco, not Kern,[5] and the possibility of exercise of, or profit or loss on, the option turned upon the long-term market price of nonexistent securities of a company in which Occidental was not an insider and could not be presumed to be under § 16(b).

The facts of this case and *Bershad* are wholly different, and both cases turned on their facts. This Court does not sit to review the application of accepted rules in particular cases.[6] As Justice Harlan stated:

> [D]ifferences between the Courts of Appeal in two or more circuits will not be accepted as a conflict if they can fairly be accounted for on the basis of variations in the factual situations among the cases involved.[7]

5. Section 16(b) in terms requires a purchase and sale of the securities of the same issuer.

6. *United States* v. *Johnston,* 268 U. S. 220, 227 (1925); *NLRB* v. *Waterman Steamship Corp.,* 309 U. S. 206, 208 (1940); *General Talking Pictures Corp.* v. *Western Elec. Co.,* 304 U. S. 175, 178 (1938).

7. Harlan, *Manning the Dikes,* 13 RECORD OF N.Y.C.B.A., 541, 552 (1958).

C. *The "escape hatch" does not exist.*

The claim that the decision below creates a new means to "evade" § 16(b) begs the question, for it assumes that the mechanics of § 16(b) are triggered by transactions other than purchases and sales. See *Reliance Electric Co.* v. *Emerson Electric Co., supra* (slip opinion at 5). Sham "options" will be treated as sales (13A-14A) and create no escape.

In the case of a long-term option, particularly one exercisable only long term, the alleged "escape" is from a liability that cannot exist under § 16(b)—even if it were someday expanded by Congress to cover the grant of an option. Petitioner's obscure assertion that an insider can buy stock and "reap a speculative short-swing profit upon it" by submitting to an option (Petition at 15) necessarily assumes that the insider can foresee that the premium will exceed all future changes in market price adverse to the insider's position in the option during its term. If the option is long-term then the assumption fails, because § 16(b) neither grants nor permits a presumption that an insider can effectively predict market prices more than six months ahead. Rather than an "escape," the option constitutes a prolonged encumbrance on his security position.

The option involved in this case would have no appeal for one seeking a "sure-thing profit." While Tenneco was even less engaged than the usual optionee (it could reclaim the premium merely by delaying the merger), Occidental was required to bear all downside risks for more than 6 and prospectively 14 months and was prevented from realizing interim gains. Occidental's retention of the Kern shares, inflated in price by merger prospects, carried the unusual risk of a 30% tumble to their pre-offer price if circumstances made the merger undesirable—even omitting consideration of a general market decline. If a merger did occur within the 14-month period, Occidental would retain only the premium, but whether it would profit or lose by

exercise or nonexercise depended wholly upon the long-term state of the market and the fortunes of Tenneco.[8] The Court below took account of the grantor's risks (14A, 16A), and if it made any error, it was only in assuming that the Tenneco preference stock could drop merely to $75 per share (14A). In fact, when the "bottom fell out of the market," as the court envisioned it might, (*id.*), that stock traded as low as 66½.[9]

POINT II

Whether a "merger" in a particular case should give rise to §16(b) liability is not a question which warrants review.

A. *The case was correctly decided in accordance with accepted law.*

Although petitioner would urge absolute liability for Occidental solely because petitioner's predecessor and its parent were able to rush through a merger within six months, it apparently concedes that the court below applied the correct rule of law: Whether certain "unorthodox"

8. The petition inaccurately asserts that "nonexercise . . . would have left Occidental with a nearly $9 million profit by reason of the option price alone which profit should certainly be subject to recovery." (Petition at 16) If a merger did not take place or was delayed, Occidental in fact would not be left with $9 million, because it would forfeit the premium. Even if the merger occurred, Occidental would have not merely the premium, but also the continuing risk of holding the very shares petitioner claims to have been sold previously. In addition, petitioner's claim is that the premium paid should be recoverable regardless of whether there was a *sale* of equity securities, but the statute explicitly otherwise requires, *Silverman* v. *Landa, supra;* and this very different question is not even properly before the Court as a "Question Presented."

9. May 26, 1970. 211 COMM. & FIN. CHRONICLE, June 1, 1970, at 16. Petitioner seeks remand to develop evidence on "knowledge, intent and motivation" (Petition at 15 n.), issues which this Court and all others have expressly declared to be irrelevant under § 16(b). *Reliance Electric Co.* v. *Emerson Electric Co.,* (Slip Opinion at 7 & n.4); see, *e.g., Blau* v. *Lamb,* 363 F.2d 507, 522 (CA 2 1966), *cert. denied,* 352 U. S. 1002 (1967).

transactions (mergers, conversions, and the like) are to be deemed "purchases" or "sales" under § 16(b) turns on whether the transactions allowed "an insider to use inside information unfairly," *Blau* v. *Lamb, supra,* 363 F.2d at 516.[10] That test has repeatedly been applied by the several courts of appeals, and in each instance this Court has denied review.[11] The application of that rule to a particular merger or other exchange is not a question which merits the Court's consideration.

Each such situation has turned on its own facts, and here there was no chance for abuse of confidential information in the merger exchange. Occidental had no prior relationship to the issuer; before Tenneco made any offer Occidental was already committed; Occidental's purchases were made in the spotlight of a publicized tender offer available to all shareholders; the exchange "in which all shareholders were entitled, indeed were forced to participate" (10A), was pro rata and was itself a maneuver employed to displace Occidental and controlled by its adversaries. The court below might well have refused to deem the Kern-Tenneco merger a "sale" solely on the ground that under § 16(b) a "purchase" or "sale" should constitute an event occurring "by one's own act." See *Ferraiolo* v. *Newman, supra,* 259 F.2d at 344-45 n.2, n.3; *Shaw* v. *Dreyfus, supra,* 172 F.2d at 142. Instead the court tested the transaction by the more rigorous "possbility of abuse test" and found Occidental not to

10 Other types of abuses are not a concern of § 16(b) and come within the purview of other laws, federal and state. *Id.*, at 521, 522 n.22; *Blau* v. *Ogsbury, supra,* 210 F.2d at 427; *Falco* v. *Donner Foundation, Inc., supra,* 208 F.2d at 604; *see Roberts* v. *Eaton, supra,* 212 F.2d at 85; *Smolowe* v. *Delendo Corp.,* 136 F.2d 231, 235 (CA 2), *cert. denied,* 320 U.S. 751 (1943).

11 See *e.g., Newmark* v. *RKO General, Inc.,* 425 F.2d 348 (CA 2), *cert. denied,* 400 U.S. 854 (1970); *Blau* v. *Lamb, supra; Petteys* v. *Butler,* 367 F.2d 528 (CA 8 1966), *cert. denied,* 385 U.S. 1006 (1967); *Blau* v. *Max Factor & Co., supra; Ferraiolo* v. *Newman,* 259 F.2d 342 (CA6 1958), *cert. denied,* 359 U.S. 927 (1959).

be liable (10A-12A). The result here had been anticipated and approved by critical commentators.[12]

The assertion that this is the first case in which the transformation of shares in a merger has been held not to constitute a "sale" has no consequence. *Newmark* v. *RKO General, Inc., supra,* also decided by the court below, was the only instance in which such a transformation had been deemed a "sale", and then only under circumstances which, as the court below carefully noted, had no factual counterparts here (11A). The *Newmark* case explicitly contemplated that some mergers might be "sales" and others not, 425 F.2d at 351, and the circuit judges who sat on the *Newmark* panel concurred in the denial of rehearing here.

Petitioner would be more accurate if it stated that there has never been a case decided under § 16(b) where an "unorthodox" transaction has been deemed to be a "purchase" *or* a "sale" if the defendant had no realistic economic alternative to, or had no control over, the claimed § 16(b) violation.[13] Here the economic compulsion was more acute than in the cases cited. The only escape for Occidental from the alleged "sale" was to outbid Tenneco's richer offer,

12 Comment, *Securities Regulations—Exchange of Stock Pursuant to Merger is Sale by Insider under § 16(b) of the Securities Exchange Act of 1934,* 84 HARV. L. REV. 1012, 1021-22 (1971); Note, *Stock Exchanges Pursuant to Corporate Consolidation: A § 16(b) "Purchase or Sale"?,* 117 U. PA. L. REV. 1034, 1056-57 (1969).

13 See *Park & Tilford, Inc.* v. *Schulte, supra,* 160 F.2d at 987-8; *Ferraiolo* v. *Newman, supra,* 259 F.2d at 346; *Blau* v. *Lamb, supra,* 363 F.2d at 518-20 n.15, n.16; *Petteys* v. *Butler, supra,* 367 F.2d at 530; *Heli-Coil Corp.* v. *Webster,* 352 F.2d 156 (CA 3 1965); (no call for redemption); *Gold* v. *Scurlock,* 324 F. Supp. 1211 (E.D. Va. 1971), *appeal pending* (principal stockholders and directors of merging corporation); *Lynam* v. *Livingston,* 276 F. Supp. 104, 106 (D. Del. 1967); *Fistel* v. *Christman,* 135 F. Supp. 830 (S.D.N.Y. 1955) (controlling shareholder); *Blau* v. *Hodgkinson,* 100 F. Supp. 361 (S.D.N.Y. 1951) (option not to take stock on "purchase" side); see also *Booth* v. *Varian Associates, supra,* 334 F.2d at 5; *Roberts* v. *Eaton, supra,* 212 F.2d at 83-84; *Blau* v. *Oppenheim,* 250 F. Supp. 881, 885 (S.D.N.Y. 1966); *Perlman* v. *Timberlake,* 172 F. Supp. 246, 256 (S.D.N.Y. 1959); *cf. Alloys Unlimited, Inc.* v. *Gilbert,* 319 F. Supp. 617, 619 (S.D.N.Y. 1970).

> and thereafter sold their holdings to persons making the counter offers.[16]

Petitioner also omits to state that Congress received testimony strongly urging that it was through such tender offers that inefficient management could be challenged and that shareholders realize gains on investments that had remained greatly undervalued.[17] The committee reports weighed the testimony concerning tender offers and concluded that federal policy should avoid the creation of special advantages for either bidder or target:

> The committee has taken extreme care to avoid tipping the delicate balance of regulation either in favor of management or in favor of the person making the takeover bid.[18]

In passing the Williams Act amendments[19] subsequent to the events in this case, Congress resolved the problems surrounding cash tender offers by a balanced treatment of disclosure and regulation. This is inconsistent with petitioner's approach, which would penalize actual and chill potential bidders by automatically requiring them to return their shares at cost to the victor, in the form of a windfall

16 *Hearings on H.R. 14475 & S. 510 Before the House Committee on Interstate and Foreign Commerce*, 90th Cong., 2d Sess., at 22 (1968) (hereinafter "*House Hearings*"). Even the quotation upon which petitioner relies bears no relationship to the use of inside information. In addition, while we view the matter as of little importance, petitioner's quotation from an article appearing in *Fortune* is similarly out of context. The sentence quoted lies at the end of a paragraph expressing the view of the author that the Occidental-Kern contest was an instance where it was possible for "everyone", including the shareholders, ultimately "to come out ahead." Rukeyser, *Getting Tough with Tenders*, FORTUNE, Aug. 1967 at 109.

17 S. REP. No. 550, 90th Cong., 1st Sess. 3 (1967).

18 *Id.* at 3. Almost identical language is set forth in H. R. REP. No. 1711, 90th Cong., 2d Sess. 4 (1968).

19 §§ 13(d),(e); 14(d),(e),(f) of the Act; 15 U.S.C. §§ 78m (d),(e); 78n(d),(e),(f).

recovery, and thereby finance their own defeat. Since the conventional rules of § 16(b) did not call for such a result here, the court below did not have to reach this issue, but noted the necessary effect of petitioner's theory:

> Indeed, if we considered the question here under discussion to be closer than we do, we would be seriously concerned over the policy implications of ruling in appellees' favor. . . . This would discourage the making of such offers, which often operate to the great benefit of stockholders of the target corporation, as appears to have been the case here. (12A, 13A)

Congress enacted § 16(b) for the wholly different and particularly insidious problem of "in and out" trading on inside information. Petitioner's position would, at the least, require defeated bidders to engage in wasteful opposition solely to delay such mergers, and it merits no consideration.[20]

C. *There is no question of sufficient recurrence or breadth to warrant review.*

This case reflects conditions and responses that prevailed during the merger activity of the mid-1960's. Even then the authors of the work which the then Chairman of the SEC referred to as the most extensive study of takeover

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20 Congress was aware of the existence of § 16(b) in considering the "delicate balance." Prompted by the testimony of the then Chairman of the SEC quoted by petitioner (later clarified) and some newspaper articles, Rep. Moss asked whether any profits made by a defeated bidder were recoverable. The Chairman replied that § 10 covered actual attempts to manipulate but § 16(b) could not be relied upon in such situations since: (1) the offeror may not be a ten percent owner "at the time of" the acquisition; (2) the offeror's holdings may never reach ten percent; *House Hearings* 30; (3) a merger may not be considered to be a "sale"; (4) it may not be proper to match the purchase of securities acquired with those of a different company resulting from the merger. *House Hearings* 75-76.

bids,[21] referred to a "defensive merger" as an "if all else fails" event.[22] Another study noted:

> Realistically this is not a defense tactic, but rather a form of orderly retreat, and one would expect that unless such a merger was being actively considered prior to the tender offer, it would be viewed by incumbent management only as a last, albeit very effective, resort.[23]

More sophisticated "defensive" techniques have since come into prominence,[24] and, with an apparent decline in adversary take-over bids, there seems little reason to expect any significant number of managements turning to the "last resort" of the "defensive merger". Fewer contests yet will involve the rare instance presented here, where a merger was procured and rushed through so hastily as to create a question under § 16(b).[25] Section 16(b) may apply in some instances where defensive mergers occur and not in others, but this presents no broad recurring question which merits review by this Court, given the alertness of the lower courts and the want of a conflict.

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21 *House Hearings* 22.

22 Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 142 (1967), reprinted in *Hearings on S. 510 Before the Subcommittee on Securities, Comm. on Banking and Currency*, 90th Cong. 1st Sess. (1967), App. 2.

23 Schmults & Kelly, *Cash Take-Over Bids—Defense Tactics*, 23 BUS. LAW 115, 132 (1967).

24 Such as changes in capital and voting structures; various means of increasing the number of target shares, including acquisitions by the target; dividend and accounting changes; antitrust litigation; and so forth. *See e.g.*, O'Hanlon, *Goodrich's Four Ply Defense*, FORTUNE, July 1969 at 10. Note, *Defensive Tactics Employed by Incumbent Management in Contesting Tender Offers*, 21 STAN. L. REV. 1104, 1111-27 (1969).

25 Indeed the petitioner can cite only one other case in the 37 year history of the Act involving the problem of a defensive merger under § 16(b), the opinion in which has been withdrawn, and even that case differs significantly from this one. In *American Standard, Inc.* v. *Crane Co.*, 1971 CCH Fed. Sec. L. Rep. ¶ 93,237 (S.D.N.Y.

D. *No judicial "exemption" from §16(b) was granted.*

Contrary to petitioner's claim, the ruling below granted no ad hoc exemption from § 16(b). The transaction here was not within the language or intendment of the Act. Insofar as petitioner's claim raises the question whether courts in unusual situations may construe the terms "purchase" and "sale" under the accepted test, it would appear to have been disposed of by this Court's approval of the process by which "courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse." *Reliance Electric Co.* v. *Emerson Electric Co., supra* (slip opinion at 7 n.4) Petitioner's position has been firmly rejected by the courts of appeals, review has been denied in each instance,[26] and it clearly deserves no further consideration.

Oct. 12, 1971) (withdrawn), the defendant's accumulation of 10 percent of the issuer's shares was accomplished in private market purchases and its tender offer 4 months later was made after it was explicitly informed that "agreement had been reached" on a merger between the target company and another bidder. All of Occidental's purchases were pursuant to a publicized tender offer and extension thereof made before Kern had any offer of merger. The differences need not compel a finding of liability in *American Standard;* it is sufficient to note that they must be considered.

26 See *Newmark* v. *RKO General, Inc., supra,* 425 F.2d at 351; *Blau* v. *Max Factor & Co., supra,* 342 F.2d at 307 n.5; *Petteys* v. *Butler, supra,* 367 F.2d at 536; *Blau* v. *Lamb, supra,* 363 F.2d at 519. Petitioner stresses Mr. Justice Blackmun's dissent in *Petteys* v. *Butler, supra,* which would appear to have rested primarily on adherence to the principle of *stare decisis* within his own circuit at that time. 367 F.2d at 538-39.

CONCLUSION

The decision below was correct and is consistent with the decisions of this Court and the courts of appeals. There is no conflict; each case depends upon analysis of the impact of its particular facts. The court below has been alive to the need to penalize and prevent short-term use of "inside" information, and its decision is in accord with the language and purpose of the statute. There was thus no basis upon which petitioner could extract windfall recovery from Occidental by reason of acts for which it was directly and indirectly responsible. The petition should be denied.

Respectfully submitted,

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